

Message Text

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PAGE 01 BUDAPE 01777 01 OF 02 081628Z

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ACTION EUR-25

INFO OCT-01 ISO-00 USIA-15 AID-20 CIAE-00 COME-00 EB-11

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SP-03 CIEP-02 LAB-06 SIL-01 OMB-01 NSC-07 SS-20

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R 081232Z JUL 74

FM AMEMBASSY BUDAPEST

TO SECSTATE WASHDC 1579

INFO AMEMBASSY BUCHAREST

AMEMBASSY MOSCOW (BY POUCH)

AMEMBASSY PRAGUE (BY POUCH)

AMEMBASSY SOFIA (BY POUCH)

AMEMBASSY WARSAW (BY POUCH)

C O N F I D E N T I A L SECTION 1 OF 2 BUDAPEST 1777

E.O. 11652: GDS

TAGS: HU, US, ECON, PFOR, PINT

SUBJ: QUARTERLY REPORT ON MAJOR ECONOMIC AND

POLITICAL TRENDS -- PART 2 OF 2 PARTS

REF: BUDAPEST 1768 AND 1771

1. ECONOMIC DEVELOPMENTS: HUNGARIAN ECONOMY CONTINUED TO GROW AT A RAPID PACE DURING EARLY MONTHS OF 1974. PRODUCTION IN INDUSTRY ROSE 7.4 PERCENT, APPROXIMATELY 2 PERCENT HIGHER THAN PLANNED, WHILE OVERALL INDUSTRIAL PRODUCTIVITY WAS UP 5.9 PERCENT. OUTPUT OF HUNGARIAN AGRICULTURE ALSO ROSE AT A HIGHER RATE THAN PLANNED AND PRELIMINARY OUT-LOOK FOR 1974'S HARVEST IS GOOD.

NEVERTHELESS, THERE ARE SERIOUS PRESSURES ON ECONOMY RESULTING FROM WESTERN INFLATION, TREMENDOUS JUMP IN RAW
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PAGE 02 BUDAPE 01777 01 OF 02 081628Z

MATERIAL PRICES, NEED TO MAKE LARGE INVESTMENTS TO MODERNIZE

HUNGARIAN INDUSTRY, AND FACT THAT FURTHER ECONOMIC GROWTH MUST COME ALMOST EXCLUSIVELY FROM INCREASED PRODUCTIVITY AS POPULATION IS NOT LOW. WHILE GOH HAS BEEN ABLE DURING FIRST HALF OF YEAR TO HOLD DOMESTIC PRICES IN CHECK THROUGH EXTENSIVE SUBSIDY PROGRAM TO ASSIST HUNGARIAN MANUFACTURERS ADVERSELY AFFECTED BY HIGHER PRICES FOR BASIC MATERIALS IMPORTED FROM WEST, COST OF THIS PROGRAM HAS BEEN FAR LARGER THAN ANTICIPATED. WHILE HUNGARIANS EXPECTED IN JANUARY THAT SUCH SUBSIDIES WOULD TOTAL 10 BILLION

FORINTS IN 1974 (AS COMPARED TO 6 BILLION FORINTS IN 1973), PRESENT ESTIMATE IS THAT 25 BILLION FORINTS -- ONE-TENTH OF NATIONAL BUDGET -- WILL BE SPENT. UNEXPECTED COST OF ANTI-INFLATION PROGRAM RECENTLY FORCED REASSESSMENT OF GOH POLICY.¹⁷ 8, MID-MAY SIGNIFICANT INCREASES IN PRODUCER PRICES FOR OIL, GAS, METALS, BASIC CHEMICALS, AND MATERIALS FOR TEXTILE INDUSTRY WILL BE INTRODUCED IN JANUARY 1975 INSTEAD OF JANUARY 1976. IN JUNE FINANCE MINISTER FALUVEGI ANNOUNCED THAT CONSUMER PRICES FOR HEATING OIL, GASOLINE, AND OTHER FUELS WOULD ALSO BE INCREASED IN NOT TOO Distant FUTURE, TOGETHER WITH COUNTERVAILING WAGE INCREASES FOR A SUBSTANTIAL PART OF POPULATION. HE LATER TOLD AMBASSADOR THAT OTHER CONSUMER PRICE INCREASES WERE "NOT YET" NECESSARY. BUT IT IS CLEAR THAT PRESENT SUBSIDY POLICY IS A HEAVY ADMINISTRATIVE AND FINANCIAL BURDEN AND THAT EFFECTS OF INFLATION HERE WILL INCREASINGLY TAKE COURSE OF PRICE INCREASES, AS THEY HAVE ALREADY DONE EVERYWHERE ELSE.

2. BALANCE OF TRADE: PRELIMINARY INDICATIONS ARE THAT HUNGARY WILL BE UNABLE TO REPEAT ITS 1973 FOREIGN TRADE PERFORMANCE WHICH SAW A \$100 MILLION SURPLUS IN TRADE WITH NON-COMMUNIST COUNTRIES. HIGH COST OF RAW MATERIALS, HYDROCARBONS AND MACHINERY PURCHASED ON WORLD MARKET, A SOFTENING IN WORLD AGRICULTURE PRICES AND IMPOSITION OF FOREIGN IMPORT RESTRICTIONS, ESPECIALLY BY ITALY, MAKE IT PROBABLY THAT HUNGARY WILL REGISTER A DEFICIT IN ITS TRADE WITH NON-CEMA AREAS IN 1974. AT SAME TIME HUNGARY HAS GEARED ITS 1974 IMPORT POLICY TOWARD ELIMINATING LARGE UNWANTED TRADE SURPLUS WHICH HUNGARY HAD WITH CEMA

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PAGE 03 BUDAPE 01777 01 OF 02 081628Z

AREA IN 1973. PROGRAMS TO STIMULATE IMPORTS OF MACHINERY FROM HUNGARY'S CEMA PARTNERS APPEAR TO BE MEETING WITH SOME SUCCESS. HUNGARY'S SURPLUS WITH CEMA DURING FIRST FOUR MONTHS OF 1974 WAS ONLY 366 MILLION DEvisa FORINTS (DFT) IN COMPARISON TO 1,052 MILLION DFT DURING SAME PERIOD IN 1973.

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PAGE 01 BUDAPE 01777 02 OF 02 081607Z

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C O N F I D E N T I A L SECTION 2 OF 2 BUDAPEST 1777

3. INVESTMENT: INVESTMENT IN HUNGARY ALSO CONTINUES TO LAG IN SPITE OF PLANS TO INCREASE RATE OF INVESTMENT BY 10-11 PERCENT IN 1974. TOTAL INVESTMENT DURING FIRST THIRD OF YEAR WAS 24.3 BILLION FORINTS, A MERE 3.1 PERCENT ABOVE 1973 FIGURE FOR SAME PERIOD. PACE OF INVESTMENT HAS BEEN PARTICULARLY SLOW AT TEN LARGEST INVESTMENT PROJECTS, WHICH ARE OF PARTICULAR IMPORTANCE FOR HUNGARIAN ECONOMY. TO HELP FINANCE NEW INVESTMENT HUNGARY HAS STEPPED UP BORROWING FROM WESTERN SOURCES. DURING SECOND QUARTER OF 1974 TWO MAJOR LOANS WERE ANNOUNCED, A \$100 MILLION LOAN FROM A CONSORTIUM OF US AND CANADIAN BANKS HEADED BY KUHN LOEB AND A \$50 MILLION CREDIT FROM A GROUP HEADED BY CREDITANSTALT OF VIENNA. HUNGARIAN OFFICIALS HAVE STATED THAT ECONOMY IS ABLE TO INCUR SIZEABLE ADDITIONAL FOREIGN DEBTS WITHOUT TAKING ON A DANGEROUSLY HEAVY LOAN, AND WE EXPECT THAT AN ACTIVE SEARCH FOR ADDITIONAL FOREIGN CREDITS WILL BE CONTINUED.

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PAGE 02 BUDAPE 01777 02 OF 02 081607Z

4. CEMA: HUNGARY IS BECOMING MORE INTIMATELY INVOLVED WITH VARIOUS CEMA INTEGRATION PROJECTS AND, IN PARTICULAR, IS MAKING PREPARATIONS TO PARTICIPATE IN A NUMBER OF LARGE-SCALE INVESTMENT PROJECTS TO TAP SOVIET NATURAL RESOURCES. HUNGARY WILL ALMOST CERTAINLY MAKE SIZEABLE INVESTMENTS IN LARGE CELLULOSE PROJECT BEING CONSTRUCTED IN EASTERN SIBERIA, ORENBERG GAS PIPELINE PROJECT, AND A STEEL COMPLEX TENTATIVELY SCHEDULED FOR KURSK. HIGH HUNGARIAN OFFICIALS HAVE INFORMALLY INDICATED THERE THESE PROJECTS ARE JUST BEGINNING AND THAT A NUMBER OF OTHER INVESTMENTS IN SOVIET UNION ARE ON DRAWING BOARDS. NEED TO DIVERT HUNGARIAN RESOURCES FOR INVESTMENT IN SOVIET UNION WILL OBVIOUSLY RESULT IN LESS ASSETS AVAILABLE FOR DOMESTIC DEVELOPMENT PROGRAMS AND WE HAVE RECENTLY HEARD CONSIDERABLE AMOUNT OF GENERAL GRUMBLING FROM OFFICIALS OF INDUSTRIAL MINISTRIES AND MINISTRY OF AGRICULTURE REGARDING RESTRAINTS WHICH ARE BEING PLACED UPON THEM BY MINISTRY OF FINANCE. ALTHOUGH CONSIDERABLE CONCERN UNDOUBTEDLY EXISTS IN GOH REGARDING IMPLICATIONS OF EVEN CLOSER ECONOMIC TIES WITH SOVIET UNION AS RESULT OF PLANNED INVESTMENTS, THERE APPEARS TO BE LITTLE ALTERNATIVE FOR RESOURCE-POOR HUNGARY. RATHER, EXACT SIZE OF HUNGARIAN INVESTMENT AND PRICES TO BE PAID FOR SOVIET RAW MATERIALS APPEAR TO BE PRINCIPAL OUTSTANDING ISSUES TO BE SETTLED AT THIS POINT.

5. US-HUNGARIAN COMMERCIAL RELATIONS: ABSENCE OF MFN CONTINUES TO POSE MOST IMPORTANT OBSTACLE TO A RAPID INCREASE IN US-HUNGARIAN TRADE. NONETHELESS, BILATERAL TRADE DURING FIRST FOUR MONTHS OF YEAR TOTALED ALMOST \$39 MILLION, DOUBLE THE AMOUNT RECORDED DURING FIRST FOUR MONTHS OF 1973. HUNGARIANS HAVE CONTINUED TO MAKE IT CLEAR THAT THEY ARE PARTICULARLY INTERESTED IN EXPANDING COMMERCIAL RELATIONS WITH US (ALSO WITH JAPAN), AND GAVE WARM RECEPTIONS TO FIVE TRADE MISSIONS WHICH HAVE VISITED HERE SO FAR THIS YEAR. ESPECIALLY SUCCESSFUL WAS EXECUTIVE LEVEL TRADE MISSION IN APRIL LED BY FRANK ZARB OF OMB, WHICH WAS RECEIVED ENTHUSIASTICALLY BY ECONOMY'S TOP DECISION-MAKERS. OTHER HIGH-LEVEL VISITORS INCLUDED CHAIRMAN BURNS OF THE FEDERAL RESERVE BOARD,

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PAGE 03 BUDAPE 01777 02 OF 02 081607Z

PEPSI-COLA PRESIDENT KENDALL, AND PRESIDENT OF US CHAMBER OF COMMERCE. DURING VISIT OF LATTER, A FORMAL AGREEMENT

INITIALED BETWEEN AMERICAN AND HUNGARIAN CHAMBERS FOR
EXCHANGE OF INFORMATION, MUTUAL ASSISTANCE AND A JOINT

ANNUAL MEETING.

RE BUSINESS FACILITATION, FIRST FORWARD PROGRESS WAS
MADE IN SECOND QUARTER, THOUGH NOT YET WITH US FIRMS.
IN MAY HUNGARIANS GAVE PERMISSION TO CREDITANSTALT
BANK OF VIENNA TO OPEN AN OFFICE IN BUDAPEST. WE FEEL
THAT THERE IS A DISTINCT POSSIBILITY THAT OTHER SELECTED
WESTERN FIRMS MAY RECEIVE THE AUTHORIZATION TO ESTABLISH
OFFICES IN BUDAPEST IN NOT TOO DISTANT FUTURE. IN
ADDITION, HUNGARY FINALLY ACTIVATED IN JUNE THE 1969 AND 1972
LAWS PERMITTING THE ESTABLISHMENT OF JOINT COMPANIES IN
HUNGARY WITH UP TO 49 PERCENT FOREIGN PARTICIPATION, FIRST
IN NON-PRODUCTION VENTURE WITH A GERMAN FIRM (SIEMENS), THEN WITH
A SMALL PRODUCTION VENTURE FOR EXPORT WITH VOLVO OF
SWEDEN. WHETHER IN ABSENCE OF MFN LEGISLATION
SIMILAR STEPS WILL BE TAKEN WITH US FIRMS IS HARD TO
PREDICT AT THIS POINT.
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